HIGHLIGHTS

Financial	1986	1985	1984
Revenues	**$ 628,581**	$ 422,468	$ 5,800
Cash flow (deficiency) from operations	**(84,497)**	(16,574)	(325,324)
Net loss	**370,455**	134,528	495,384
Capital expenditures	**3,662,655**	2,653,182	792,150
Total assets	**9,479,388**	4,772,435	4,646,119
Shareholder's equity	**8,999,633**	4,370,088	4,504,616

Operating			
Production — Barrels per day	**110**	55	—
Wells participated in			
Gross	**28**	13	3
Net	**16**	6.2	0.65
Land Holdings — acres			
Gross	**37,387**	19,529	1,280
Net	**32,898**	13,436	532
Proved reserves before royalties (barrels)	**1,081,000**	375,600	—

Metric Conversion Factors

1 cubic metre = 6.29 barrels petroleum liquid (oil)
= 35.49 cubic feet natural gas
1 hectare = 2.47 acres
1 kilometer = 0.62 miles

CHAIRMAN'S MESSAGE

During the 1986 fiscal year, the Manitoba Oil and Gas Corporation again demonstrated its value to Manitoba through the role it has played in the development of the provincial oil industry.

In establishing the Corporation, part of the Government's expectations for the Company were:

- "to act as a catalyst in the development of Manitoba's petroleum resources", and,
- "to provide a vehicle for stabilizing oil and gas exploration and development activities in the province during downturns in the industry".

Due to the dramatic decline in oil prices in early 1986, many out-of-province operators severely cut back activity within Manitoba for the balance of the year.

In keeping with its mandate, the Corporation accelerated its own exploration and development programs and by year end had participated in 20 percent of the wells drilled in the province during 1986.

This increased activity on the part of the Corporation helped to provide much needed work for Manitoba's contracting and service sector.

For the above noted reasons, the Government has agreed to continue to provide equity funds to finance the Corporation's programs. This will allow the Company to continue to find and develop additional oil reserves thereby enabling it to expand its reserve base in the anticipation of better returns in future years.

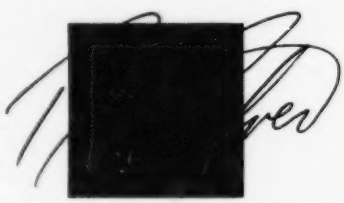
As Chairman of the Board of Directors, I am honoured to be associated with the achievements which are detailed in this annual report and to express my appreciation to the members of the Board and our employees through whose efforts we have been able to achieve so much in the way of economic stimulus and development and asset growth in so short a period of time.

During the year there were some changes to the Board of Directors.

Mr. Phil Eyler retired from the Board on November 12, 1986. We wish to thank Mr. Eyler for his contribution during the formative years of the Corporation.

Mr. Andrew Janisch was appointed to the Board on November 12, 1986. We welcome Mr. Janisch and look forward to his association during the coming years.

The progress and developments of the past year clearly illustrate the Manitoba Oil and Gas Corporation's capacity to respond to the changing circumstances of the industry. In doing so, the Corporation has earned a reputation as a dynamic and capable organization with the people and expertise required to meet the challenges of the future.



Robert M. Silver
Chairman

PRESIDENT'S MESSAGE

Notwithstanding the difficult operating environment prevalent in the oil and gas industry during the past year, 1986 was still a year of notable achievements for the Corporation.

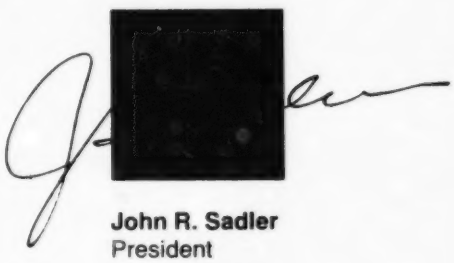
The Company participated in drilling 28 gross wells during the year which resulted in 23 oil wells; increasing the company's proven reserve base to 1.08 million barrels compared with 375 thousand barrels a year ago.

During the year MOGC's average daily oil production increased to 110 barrels per day at year end from 55 barrels in 1985.

In keeping with a philosophy of internal prospect generation, the Company substantially increased its land holdings during 1986. This additional acreage will allow us to continue to delineate new reserves within the Province.

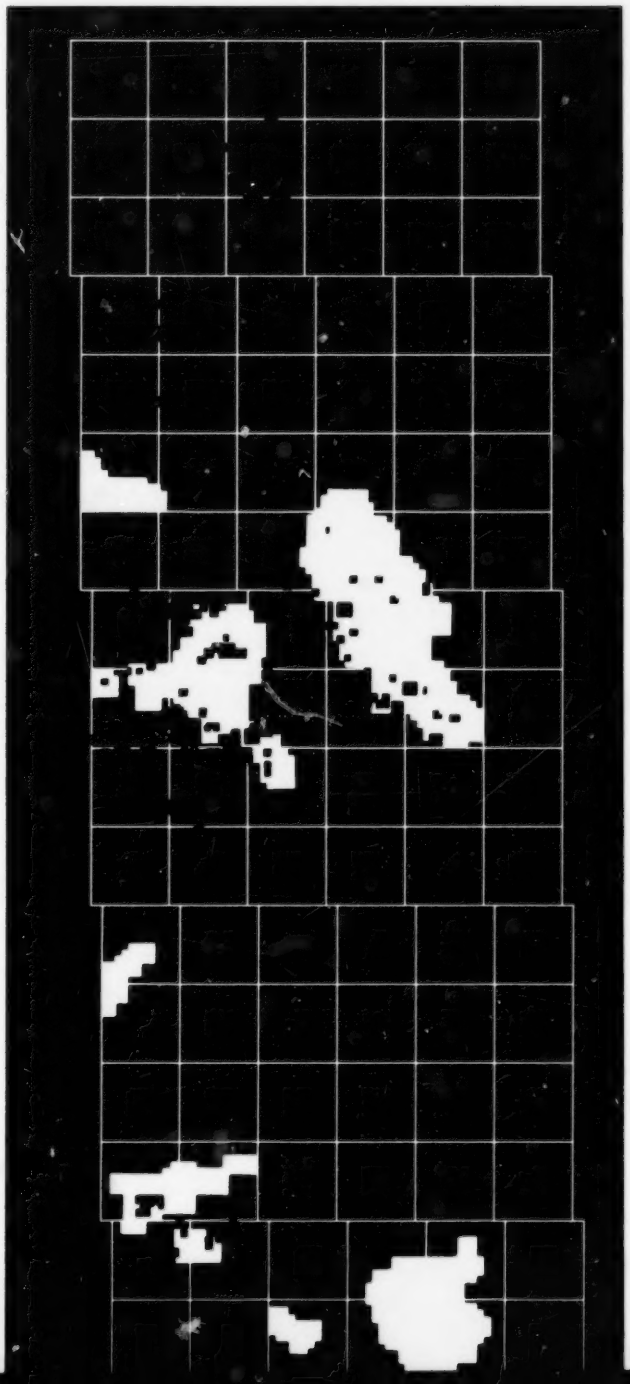
During the fall of 1986, the Company established a field office in Virden which has enabled us to begin operating our own internally generated prospects.

Although there is still considerable uncertainty in the oil and gas industry, the Company feels that the future of our industry is sound. Statistics for Western Canada indicate that more hydrocarbons are currently produced than reserves are being added each year. Reserves discovered at today's price levels should prove to be an excellent long-term investment for the Shareholder.



John R. Sadler
President

EXPLORATION AND DEVELOPMENT



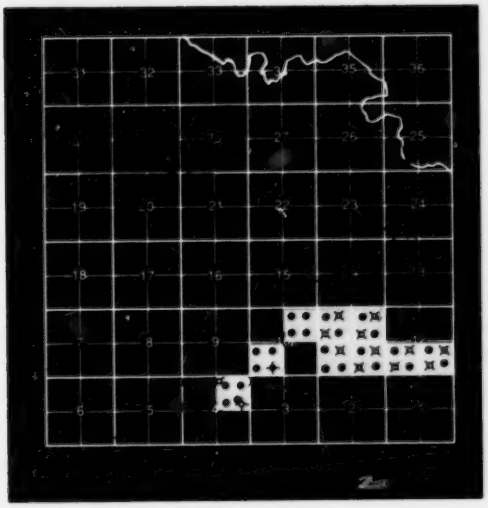
MOGC's drilling activity increased significantly during 1986 with the Company participating in a total of 28 gross wells compared to 13 a year ago.

Of the total wells participated in, 23 were classified as oilwells, 2 were abandonments, 2 were converted to salt water disposal wells and one was a direct acquisition. The overall results reflect a success rate of over 80 percent.

As part of the Company's active exploration and development programs, MOGC undertook a substantial leasing program in order to augment its existing land base. By year end MOGC had increased its land holdings by 91 percent to 37,387 gross acres (32,898 net) compared to 19,529 gross acres (13,436 net) a year ago. With this sizeable land base, the Company has better positioned itself for future exploration and development.

Southwestern Manitoba

- ■ MOGC land position
- □ Producing oil fields



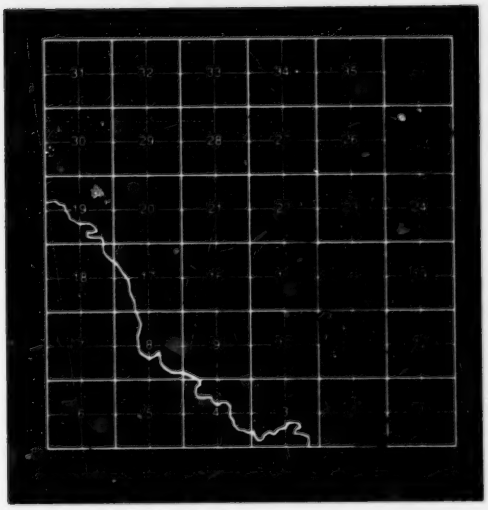
North Daly

Seven wells were drilled in this area during the year and successfully completed. Six were classified as development locations and one was classified as an exploratory test.

This area is of particular interest to the Company due to the recent establishment of Bakken production in conjunction with multi-zone Lodgepole production.

The Company holds an average 29 percent working interest in these wells and has interests ranging from 25 to 50 percent in 1280 gross (355 net) undeveloped acres within the area.

Further development drilling is planned for this area in 1987.



MOGC land holdings

MOGC well locations

MOGC land holdings – deep rights only

North Ebor

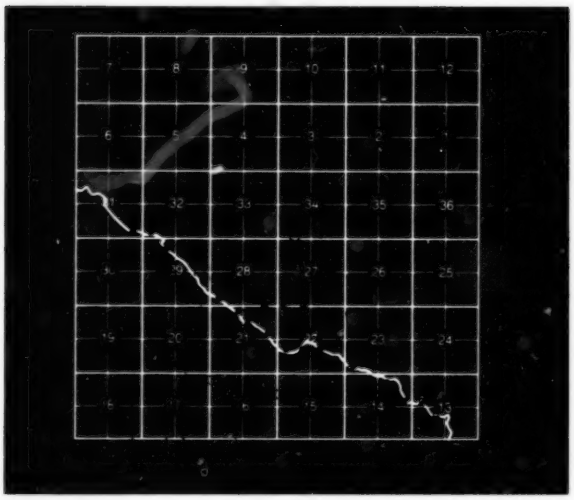
Four wells were drilled and successfully completed in this area. Additionally, an existing well was converted to a salt water disposal well during the year.

Three of these wells were considered as exploratory tests with the remaining well being classified as a development location.

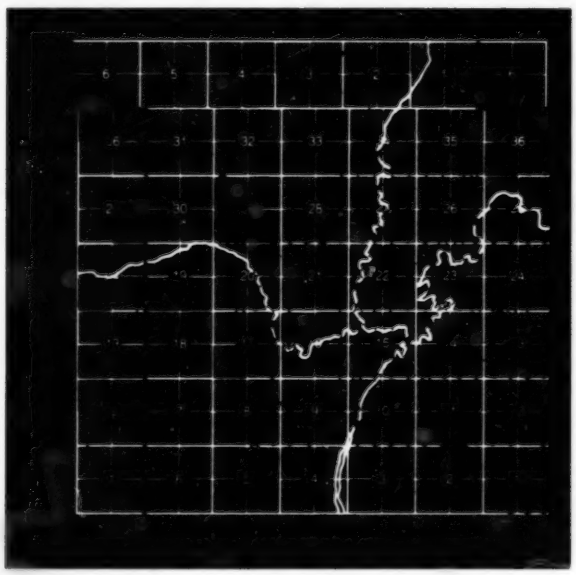
This area is of particular interest to the Company due to the presence of Lodgepole multi-zone production potential and possible Bakken sand development.

The Company holds an average 77.5 percent working interest in these wells and has interests ranging from 25 to 100 percent in 1960 gross (1554 net) undeveloped acres within the area.

Further exploratory and development drilling is planned for the area during 1987.



North Virden
The Company holds a 50 percent working interest in two successful oil wells which were drilled during 1985. In order to increase recoverable reserves, plans for the proposed North Virden Scallion Unit No. 2 waterflood scheme are proceeding with ICG Resources as designated Operator. The Unit is expected to be formed during 1987.



Virden
Three wells were drilled within this area during the year resulting in two oil wells and one salt water disposal well.

The Company holds an average 50 percent working interest in the wells and has interests ranging from 50 to 100 percent in 1230 gross (1170 net) undeveloped acres within the area.

Further exploratory and development drilling is anticipated in this area during 1987.

MOGC land holdings
MOGC well locations

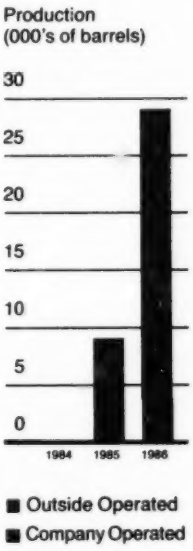
PRODUCTION AND RESERVES

The Company's production increased significantly from 55 barrels per day a year ago to 110 barrels per day by December, 1986.

Most of MOGC's production is generated from the four key areas previously highlighted. Production from these areas is projected to represent an even greater portion of total production as a result of proposed infill drilling programs scheduled for 1987.

In September, the Company established a field office in Virden and began operating its own wells. This will result in a significant shift from partner-operated to Company-operated wells in the future.

Of the Corporation's 23.4 net wells, 10.8 were producing a total of 110 BOPD at December 31, 1986; an average of 10 BOPD. Of the remaining wells, 3.05 wells were testing and/or being completed as potential producers, 3.75 wells were classified as salt water disposal wells, 3.4 wells were suspended, and 2.4 wells had been abandoned as unsuccessful.



Reserves

The Company's oil reserves and the future cash flows attributable to these reserves are reviewed and evaluated annually by independent petroleum engineers.

A successful exploration and development program during the past year resulted in the discovery of 732,500 barrels of additional proved oil reserves which represents a 95 percent improvement over reserves discovered in 1985. The majority of the Company's reserves are located in the N. Daly, N. Ebor, N. Virden and Virden areas of the province.

Proved Reserves Summary

	1986	1985
Barrels		
Balance, January 1	**375,600**	—
New reserves added	**896,000**	383,100
Revisions	**(163,500)**	—
Reserves produced	**(27,100)**	(7,500)
Balance December 31	**1,081,000**	375,600

Notes

Proved reserves are the estimated quantities of crude oil which geological and engineering data demonstrate with reasonable certainty to be recoverable in future years under existing economic and operating conditions.

The process of estimating reserves is complex, requiring professional judgements in the evaluation of available geological, engineering, economic and other data.

AUDITOR'S REPORT

To the Shareholders of The Manitoba Oil and Gas Corporation

We have examined the balance sheet of The Manitoba Oil and Gas Corporation as at December 31, 1986 and the statement of operations and deficit and changes in cash resources for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these financial statements present fairly the financial position of the Company as at December 31, 1986 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

March 25, 1987

Deloitte Haskins & Sells

Chartered Accountants

FINANCIAL REVIEW

Overview
1986 represents the third year of the Company's existence and essentially its second year of active involvement in the industry. The current fiscal year reflects significant growth in a number of important areas such as production and reserves additions. These gains were made in spite of sharp reductions in the industry in virtually all upstream activities.

Revenue
Operating revenues after royalties increased 80 percent to $433,000 from $240,000 in 1985. This increase was achieved in a year that saw prices fall dramatically to an average of $18.70 per barrel in 1986 from $38.30 per barrel in 1985; a 50 percent drop overall.

Production levels rose to just over 27,000 barrels from 7,500 barrels a year ago. Royalties increased as a percent of sales from 9 percent to 10.6 percent. However, royalty costs remain generally low and reflect incentives available from production on crown land.

Additional revenues of $170,000 were realized from the Company's ten percent interest in the Waskada-Cromer oil pipeline located in southwestern Manitoba.

Expenses
Production and operating costs increased 180 percent over 1985 compared with an increase in production of 260 percent. General and administrative expenses increased $109,400 reflecting expansion in all areas of operations including the establishment of a field office in Virden.

Capital Program
Capital Expenditures rose $3,662,000 for a total investment of $7,087,000 in property and equipment reflecting significant growth in our exploration and development programs.

There was also a shift in emphasis from expenditures on mineral rights acquisitions to drilling and development of production facilities. Expenditures on drilling, equipping and facilities amounted to $2.5 million.

Liquidity
During 1986, additional shares were subscribed for $5,000,000. As a result, working capital increased during the year to $2,478,000 from $1,213,000. There was a net cash flow deficiency from operations of $84,500.

BALANCE SHEET

As at December 31, 1986	1986	1985
Assets		
Cash	$ 75,049	$ 139,373
Funds held in trust (note 4)	2,600,000	1,100,000
Accounts receivable	113,373	78,591
Drilling advances	115,963	255,320
Inventories	29,748	34,640
Deposits and prepaid expenses	23,890	7,193
	$ 2,958,023	$1,615,117
Property and equipment less accumulated depletion, depreciation and amortization (note 3)	$ 6,521,365	$3,157,318
	$ 9,479,388	$4,772,435
Liabilities		
Accounts payable	$ 479,755	$ 402,347
Equity, Province of Manitoba		
Share capital (note 4)	$10,000,000	$5,000,000
Deficit	1,000,367	629,912
	$ 8,999,633	$4,370,088
	$ 9,479,388	$4,772,435

The accompanying notes are an integral part of this balance sheet.

Approved on Behalf of the Board

Director

Director

STATEMENT OF OPERATIONS AND DEFICIT

For the Year Ended December 31, 1986

	1986	1985
Revenue		
Petroleum sales	$ 484,134	$ 263,577
Less: Royalties	51,206	23,608
	$ 432,928	$ 239,969
Pipeline fees	169,737	165,780
Interest and other income	25,916	16,719
	$ 628,581	$ 422,468
Expenses		
Production and operating	$ 255,816	$ 91,192
General and administrative	457,262	347,850
Depletion, depreciation and amortization	$ 285,958	$ 117,954
	$ 999,036	$ 556,996
Net loss for the year	$ 370,455	$ 134,528
Deficit, beginning of year	$ 629,912	$ 495,384
Deficit, end of year	$ 1,000,367	$ 629,912

The accompanying notes are an integral part of this statement.

STATEMENT OF CHANGES IN CASH RESOURCES

For the Year Ended December 31, 1986

	1986	1985
Cash flow (deficiency) from operations		
Loss from operations	$ (370,455)	$ (134,528)
Items not affecting cash —		
Depletion, depreciation and amortization	285,958	117,954
Cash flow (deficiency) before working capital changes	$ (84,497)	$ (16,574)
(Increases) decreases in operating working capital —		
Accounts receivable	$ (18,128)	$ (57,099)
Inventories	4,892	(34,640)
Deposits and prepaid expenses	(16,697)	333
Accounts payable	43,583	14,697
	$ 13,650	$ (76,709)
	$ (70,847)	$ (93,283)
Capital expenditures		
Property and equipment	$(3,493,477)	$(2,653,281)
Financing activity		
Issuance of share capital	$ 5,000,000	—
Cash provided (required)	$ 1,435,676	$(2,746,564)
Cash, beginning of year	$ 1,239,373	$ 3,985,937
Cash, end of year	$ 2,675,049	$ 1,239,373

"Cash" comprises cash and funds held in trust.

The accompanying notes are an integral part of this statement.

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 1986

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accompanying financial statements have been prepared by management in accordance with generally accepted accounting principles. The Corporation's more significant accounting policies are summarized below.

Joint Ventures

Substantially all of the Corporation's exploration activities are conducted jointly with others. These financial statements reflect only the Corporation's proportionate interest in such activities.

Petroleum and Natural Gas Properties

The Corporation follows the full cost method of accounting for oil and gas operations wherein all costs related to the exploration for and development of oil and gas reserves are capitalized. Such costs include lease acquisition costs, geological and geophysical expenditures, lease rentals on undeveloped properties, costs of drilling both productive and non productive wells and all technical and administrative overhead directly associated with exploration and development activities.

Proceeds received from disposals are credited against accumulated costs unless such a disposition would significantly alter the relationship between capitalized costs and proved reserves. Gains and losses on other property and equipment dispositions are recognized in the statement of operations.

Ceiling Test

The Corporation places a limit on the aggregate costs that can be capitalized as Petroleum and Natural Gas expenditures (the Ceiling Test) which conforms with the full cost accounting guideline issued by the Canadian Institute of Chartered Accountants. This "ceiling" is equal to the future net revenues from proved reserves, net of estimated future general and administrative costs, plus the lower of cost and fair market value of non producing properties.

In determining future revenues, the Company applied a price of $18.70 per barrel (1985 - $38.30) based on average posted prices during the year. No adjustment would be required if the year end price of $19.55 per barrel (1985 - $35.00) had been applied.

Depletion, Depreciation and Amortization

Depletion of oil and gas properties and depreciation of production equipment and facilities is calculated using the unit-of-production method based on estimated proved reserves of oil and gas. Costs of acquiring and evaluating unproved properties are excluded from capitalized costs to be depleted until it is determined whether or not proved reserves are attributed to the properties or impairment in value has occurred.

Cumulative expenditures excluded from costs subject to depletion and depreciation were $1,742,400 (1985 - $1,035,400).

Depreciation on other equipment is calculated at rates ranging from twenty to twenty-five percent. Leasehold improvements are amortized over the remaining term of the lease plus one renewal period.

Capitalized Costs
In applying the full cost method of accounting the Company capitalized general and administrative costs directly associated with exploration and development totalling $280,300 (1985 - $225,000).

2. STATUS OF THE CORPORATION

The Manitoba Oil and Gas Corporation was established as a Crown Corporation under the Manitoba Oil and Gas Corporation Act, Bill 4, in 1983. Under the provisions of its Act, the Corporation conducts activities to promote exploration and development of oil and gas as a direct participant in the industry.

3. PROPERTY AND EQUIPMENT

	1986			1985
	Cost	**Accumulated Depreciation Depletion & Amortization**	**Net Book Value**	Net Book Value
Petroleum and natural gas properties including exploration and development thereon	**$5,462,665**	**$313,916**	**$5,148,749**	$2,304,262
Pipeline investment	**526,399**	**116,390**	**410,009**	437,823
Production equipment	**767,446**	**46,800**	**720,646**	204,735
Other	**330,881**	**88,920**	**241,961**	210,498
	$7,087,391	**$566,026**	**$6,521,365**	$3,157,318

4. SHARE CAPITAL

As a Crown corporation, the Corporation issues share certificates to the Minister of Finance in exchange for equity financing. Proceeds available to the Corporation in respect of shares issued are held in trust by the Minister to be advanced as funds are required to finance operations.

Undisbursed funds held in trust are non interest-bearing to the Corporation.

Authorized

The Corporation is authorized to issue 200,000 shares for maximum consideration of $20,000,000.

Issued

	1986		1985	
	Shares	**Amount**	Shares	Amount
Beginning of year	**50,000**	**$ 5,000,000**	50,000	$5,000,000
Issued	**50,000**	**5,000,000**	—	—
End of year	**100,000**	**$10,000,000**	50,000	$5,000,000
Proceeds advanced		**7,400,000**		3,900,000
Funds held in Trust		**$2,600,000**		$1,100,000

5. EMPLOYEE PENSION PLAN

Under the terms of the Company's pension plan, employee contributions are matched by the Corporation and these amounts are contributed to money-purchase pension plans. As a result, there are no unfunded pension plan liabilities and no outstanding corporate obligations.

6. COMMITMENTS

The Corporation has lease commitments of $57,000 per year for the next three years.

CORPORATE INFORMATION

DIRECTORS

Robert M. Silver
Chairman
President
Manitoba Public Insurance Corporation

Alan D. Bourgeois
Lawyer

Phil Eyler
Member of the Legislative Assembly
River East Constituency
(to November 12, 1986)

Garry R. S. Hastings
Secretary Treasurer
Management Services Officer
Manitoba Energy Authority

Andrew Janisch
President, Jandess Resources Ltd.,
Calgary, Alta.
(effective November 12, 1986)

Dr. John Ryan
Professor of Geography
University of Winnipeg

MANAGEMENT

John R. Sadler
President

Warren H. Johnston
Operations Manager

Marc R. Junghans
Chief Geologist

Derek C. Longfield
Resource Development Manager

Ken J. Neufeld
Controller

Barbara A. Poruchny
Administrative Officer

Linda R. Vall
Land Manager

HEAD OFFICE

Eaton Place
870 - 330 Graham Avenue
Winnipeg, Manitoba
R3C 4A5

AUDITORS

Deloitte, Haskins & Sells
Winnipeg, Manitoba

RESERVES AUDITORS

Esau, Finn and Associates Ltd.
Vancouver, B.C.